ORIGINAL

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Price Cap Performance Review for Local Exchange Carriers	)	CC Docket No. 94-1

REPLY TO OPPOSITIONS

Pursuant to Section 1.429 of the Commission's Rules, 47 C.F.R. § 1.429, AT&T Corp. ("AT&T") replies to the oppositions of local exchange carriers ("LECs")[1] to its petition to reconsider or, in the alternative, clarify limited portions of the Commission's First Report and Order in this proceeding.[2] As shown below, the LEC filings fail to dispel AT&T's showing that the First Report and Order is flawed in limited but important respects, and that these deficiencies should be corrected

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[1] Oppositions were filed by BellSouth Telecommunications, Inc. ("BellSouth"), GTE Service Corporation ("GTE"), the NYNEX Telephone Companies ("NYNEX"), Rochester Telephone Corp.("Rochester"), Sprint Corporation ("Sprint"), and the United States Telephone Association ("USTA").

[2] Price Cap Performance Review of Local Exchange Carriers, CC Docket No. 94-1, First Report and Order, FCC 95-132, released April 7, 1995 ("First Report and Order"), erratum, released April 26, 1995.

by the Commission to properly align its rulings with the regulatory policies underlying incentive regulation.

AT&T's petition showed (pp. 2-6) that the revised mandatory and optional productivity offsets prescribed by the First Report and Order are still unduly low because they reflect only one adjustment to the current, seriously understated productivity factors -- specifically, correction of a discrepant data point in the Frentrup-Uretsky historical productivity study originally relied upon by the Commission in prescribing the LEC price cap plan.[3] The Commission simply ignored or overlooked other extensive evidence concerning the LECs' achieved productivity (including in particular AT&T's November 29, 1994 ex parte submission) when it erroneously concluded that "there is an insufficient record" on which to base a long-term "X"-factor adjustment. In particular, the inadequacy of the new "interim" offsets is underscored by the fact that all but four price cap LECs have elected the higher 5.3 percent optional productivity factor, indicating that this threshold is readily achievable by those carriers and presents no challenge to increased efficiencies on their part. Pet., pp. 4-5.

LECs that contest AT&T's showing described above assert that the 5.3 percent offset was elected, not

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[3] See First Report and Order, Appendix D.

because that performance level is sustainable (or even achievable), but simply to enable those carriers to avoid their sharing obligation that would otherwise have been triggered by selecting a lower productivity factor. For example, NYNEX states (p. 4) that these LECs "made that choice [electing the 5.3 percent offset] in order to eliminate sharing, and not because they are already achieving that level of efficiency."[4]

This argument can only be described as a remarkable non sequitur. NYNEX and the other LEC commenters do not explain why it would be economically rational for those carriers to elect an unachievable productivity target (even for an interim period), simply to avoid sharing a lesser amount of earnings in excess of their reference rate of return. The only conclusion which the Commission can draw from their recent actions is that these LECs expect to achieve earnings substantially in excess of the levels at which they would otherwise be required under the Commission's revised sharing thresholds to return all of their earnings to access ratepayers (i.e., more than 16.25 percent).[5] Earnings at or above

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[4] To the same effect, see also GTE, pp. 5-8; Sprint, p. 2; USTA, pp. 3-4.

[5] The price cap LECs' recently filed ARMIS reports likewise confirm that in most cases these carriers are continuing to achieve earnings about equal to, or even signficantly above, their already substantial 1994 returns, as shown in the table below:

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these levels can only be achieved if the LECs not only are capable of, but have in fact achieved, efficiencies far in excess of the productivity offsets prescribed in the First Report and Order. Thus, contrary to their claim the LECs' recent actions adopting the higher optional offset provide compelling evidence that the revised X-factors are still considerably understated, and should be reconsidered.[6]

Nor do the LECs controvert AT&T's showing (Pet., pp. 8-10) that the Commission erred in failing to

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1Q95 ARMIS 43-01

RBOC	Average Net Investment	1Q95 Return	1Q95 Rate of Return
Ameritech	$2,894,805	$166,387	22.99%
Bell Atlantic	$4,120,661	$179,820	17.46%
BellSouth	$4,525,092	$194,412	17.19%
NYNEX	$3,663,850	$142,428	15.55%
PacTel (Cal)	$2,462,751	$93,628	15.21%
Southwestern	$3,188,740	$126,969	15.93%
U S WEST	$3,848,869	$127,230	13.22%
TOTAL RBOC	$24,704,768	$1,030,874	16.69%
TOTAL PRICE CAP	$30,722,259	$1,278,100	16.64%

[6] Since the filing of AT&T's reconsideration petition several additional LECs have requested waivers of the First Report and Order to adopt the 5.3 percent offset retroactive to January 1 of this year. These filings simply further underscore the fact that most of those carriers necessarily expect to achieve earnings for the first portion of this year well in excess of the revenue reductions that would result from retroactively adopting the higher optional X-factor. These additional waiver filings also confirm that, as AT&T showed in its Petition (pp. 6-8), in the absence of a waiver price cap LECs are required to implement sharing for the portion of the current tariff year prior to implementation of the First Report and Order.

eliminate the lower formula adjustment mechanism ("LFAM"), which has permitted some of those carriers to recoup through temporary PCI increases expenses that are intended to make them more efficient -- a result that is completely at odds with the goals of incentive regulation. Indeed, these parties' filings clearly elucidate the inconsistency between this outcome and the goals of the Commission's LEC price cap plan. For example, NYNEX (which has used one-time charges for corporate downsizings to trigger the LFAM) concedes (p. 13 n.37) that

> "the price cap system was designed to encourage the LECs to become more efficient. Efforts to become more efficient almost always involve higher initial costs, and accounting accruals for one-time restructuring costs are necessary when a company becomes more efficient by instituting force reductions."[7]

NYNEX -- like the First Report and Order -- nevertheless fails to explain why a "backstop" mechanism permitting LECs to recover such expenditures from access ratepayers is somehow congruent with the Commission's efficiency objectives.[8]

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[7] To the same effect, GTE acknowledges (p. 19) that "[c]orporate downsizings or reengineering costs reflect management decisions that ultimately make a company more competitive, financially stronger, and more productive. Any short-run expense increases should be outweighed by the long-range benefits incurred by these types of costs" (emphasis supplied).

[8] USTA's claim (p. 17) that the waiver process is insufficient to protect price cap LECs from unusual, prolonged underearnings likewise does not withstand analysis. Those carriers now routinely file, and the Commission in the ordinary course entertains, requests

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The LECs also do not present any reasoned justification for the Commission's failure to immediately implement a "per line" formula for capping the common line basket, in lieu of the current "balanced 50/50" formula, despite the Commission's own tentative conclusion that the per line method "is superior" to the balanced formula. See First Report and Order, ¶ 271. Their pleadings simply echo the Commission's observation (id.) that such a revision may become unnecessary in the event that the Commission adopts a total factor productivity ("TFP") capping method in the next phase of this proceeding.

However, as AT&T showed in its Petition (pp. 11-12), there can be no assurance that the Commission will eventually select the TFP methodology for its LEC price cap plan or that, even if it does so, that decision can be implemented in time for the LECs' next annual tariff filings.[9] Thus, the mere fact the Commission has

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for waivers of a host of requirements prescribed by the LEC price cap plan without any apparent undue burden on the Commission's resources.

[9] The speculative nature of the Commission's stated basis for declining to adopt a per line formula while it conducts the next phase of this proceeding is underscored by the LECs' pleadings. E.g., USTA, p. 18 ("if the decision whether to adopt a TFP method has not yet been made, then there is no basis to adopt a per-line method which may be unnecessary") (emphasis supplied); Rochester, p. 8 ("To the extent that the Commission adopts a [TFP-based] productivity offset, it may become unnecessary to include a demand-cap in the common line formula") (emphasis supplied). Curiously,

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the TFP methodology under study provides no basis for refusing now to correct an error in the price cap formula that results in a significant overstatement of the LECs' proposed 1995 common line rates (as well as a potential overstatement of the 1996 rates).[10]

Finally, none of the LECs has rebutted AT&T's showing (Pet., pp. 13-14) that the Commission's failure to accord exogenous treatment to the amortization of equal access and network reconfiguration ("EANR") costs permits those carriers to recover as much as $100 million annually under their current price caps, despite the fact that the

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in view of its caveats quoted above, Rochester nevertheless claims (id.) that the Commission's finding (¶ 269) that LECs have little influence over common line usage growth is "far too cautious an assessment" to provide a basis for changing the common line capping formula.

[10] There is likewise no basis for GTE's claim (p. 23) that implementing a change in the common line formula "would require the development of a record in a further proceeding." As AT&T showed both in its Comments (pp. 26-28) and its petition (p. 4 n.8), the record already indicates the reduction in the revised productivity factor that would be required when replacing the balanced 50/50 formula with a per line methodology. As AT&T further showed (Pet., p. 12 n.14), and no LEC disputes, the fact that it would require the LECs to recompute their price cap indices is not an impediment to adopting the formula change, as the First Report and Order (¶ 24) assumes. Those carriers are already obligated to implement extensive changes to their index calculations as the result of the Commission's decision in this docket. Neither the Commission nor the LECs have provided any basis to conclude that those changes would be any more difficult than those already mandated by the First Report and Order.

LECs completed their amortizations of those expenses in 1993. Those parties do not contest AT&T's showing (id., p. 16) that, contrary to the First Report and Order's claim (¶ 305), the record in this proceeding is fully adequate to permit an informed decision by the Commission of the exogenous treatment issue.

Instead, those LECs that address this issue at all principally claim that AT&T's request for this relief is foreclosed because the Commission has previously denied exogenous treatment of EANR costs in other proceedings.[11] These parties conveniently ignore AT&T's showing (Pet., p. 15 and n.19) that the Commission's original basis for denying exogenous treatment -- namely, to reduce incentives for LECs to engage in cost shifting -- is no longer applicable with the completion of their cost amortizations. Accordingly, the Commission should reconsider its decision and adopt exogenous treatment of LEC EANR cost amortizations.

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[11] NYNEX, p. 19; Rochester, pp. 5-6; USTA, pp. 22-23.

WHEREFORE, for the reasons stated above and in AT&T's petition, the Commission should reconsider, or in the alternative clarify, the First Report and Order in accordance with AT&T's petition.

Respectfully submitted,

AT&T CORP.

By _____

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CERTIFICATE OF SERVICE

I, Ann Marie Abrahamson, do hereby certify that on this 12th day of July, 1995, a copy of the foregoing "Reply To Oppositions" of AT&T Corp. was mailed by U.S. first class mail, postage prepaid, to the parties listed on the following parties.

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